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## Intelligence Research Report

IRR-28 - July 22, 1991

### China's Defense Conversion: Lessons for the USSR? (C)

#### Summary

Both China and the USSR are struggling to switch militarized economies to more market-based, consumer-oriented systems. The Chinese have moved further along this uncharted path and may offer lessons—both positive and negative—for the Soviets. (U)

China's program was launched in the late 1970s as part of a massive industrial modernization plan. Civilian goods now account for 70 percent of defense industrial output, compared with barely 20 percent a decade ago. The defense sector—still largely state controlled—is producing an impressive array of capital equipment and large quantities of consumer goods for export as well as domestic consumption. A Chinese-sponsored international conversion conference is planned for this fall. (C)

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## The Chinese Approach

China's "conversion" program is equivalent to what the USSR calls "diversification." Under this approach, military production capacity is—in US terminology—"laid away" on site, where it is used far below capacity or not at all while resources are concentrated on civilian production.

This extremely costly system runs counter to advice offered by most US and West European industrial specialists, who recommend "mothballing" or scrapping excess or obsolete weapons tooling. Lack of confidence in mobilizing industry for a military emergency apparently accounts for Beijing's approach, as well as Moscow's.

Conversion efforts have been complicated by the strategically remote location of China's "third tier" defense industries, which have long isolated the country's best S&T and manufacturing assets from the technology-starved civilian industrial base on the coast (see map, p. 2). In addition to diversification at existing weapons plants, a major development is the relocation of personnel and equipment to coastal regions where new, "totally civilian" industrial plants are being spun off.

These new plants are still considered to fall under defense industry auspices, but in some cases they have received financial support from provinces, cities, or towns. Although these government units are partial "owners" of such plants, stock cannot be sold. Individuals hold no equity in the vast majority of these companies. (U)

## Incentives for Defense Industry

Faced with slumping military orders, many defense industrial managers have seen expansion into the successful civilian manufacturing sector as an increasingly attractive alternative. Chinese defense managers are given broad authority to select their own civilian product lines, although a veto power is retained at the ministerial level. The lure of big profits, higher wages, hard currency, and relocation from the remote interior to economically active coastal regions are important factors driving conversion.

Another factor helping the transition is Mao's legacy of preventing too much disparity between the wages and perks in China's military-industrial complex and those in civilian enterprises. The Chinese are not facing the dilemma of Soviet counterparts, who see switching to civilian products as the end of their special privileges. (U)

## Overcoming Obstacles

China's entry into new civilian products has been heavily based on imported technology and equipment. From 1978 to 1987,

Many of these imports have been instrumental in defense plants' being able to diversify into civilian production. (U)

### A Conversion Success Story

The Changhong State Machinery Factory, China's largest TV plant, was built in Mianyang in 1958 to manufacture airborne radar and other military communications equipment. Its manager attributes successful diversification of this third-tier plant to its prowess as a defense electronics producer and to access to imported Japanese equipment and components.

These factors, plus the low-paid, highly skilled work force, enable the plant to produce 1 million TVs a year, mostly color. Military electronics account for only 14 percent of production. The plant is highly profitable and has won numerous awards for quality.

Chinese officials point out, however, that as a defense producer Changhong is able to tap military R&D departments and enjoys supply priorities that give it an advantage over its purely civilian counterparts. (C)

### High-Tech Zones

China has two programs, "Torch" and "863," which are designed to promote the commercialization of research work and the advancement of Chinese technology. Military plants interested in conversion are participating in these economic development programs as much as possible to help facilitate transition to civilian production, according to Jin Zhude, director of the China Association for Peaceful Use of Military Industrial Technologies (CAPUMIT, see box, right). (U)

Under Torch, announced in 1988, more than 20 national-level zones have been created—many in commercially accessible coastal areas—to develop

### China's Conversion Apparatus

The key organizations responsible for coordinating conversion policies are the:

- Commission on Science, Technology, and Industry for National Defense (COSTIND);
- State Planning Commission (SPC);
- State Science and Technology Commission (SSTC); and
- High-Technology Plan Coordination Group. (U)

Three streamlined ministries—Energy Resources, Machine Building and Electronics, and Aerospace—were formed in the mid-1980s to implement conversion. Subordinate to the State Council, these new ministries have broad policy-enforcement and monitoring responsibilities over their affiliated civil and military plants (see chart, p. 5). Day-to-day operational control varies by ministry but in most cases is relatively limited. The ministries' primary role has been to provide direction, financing, and domestic and foreign contacts. They also monitor numerous "trade corporations" that were created to support the import and export needs of the plants. (C)

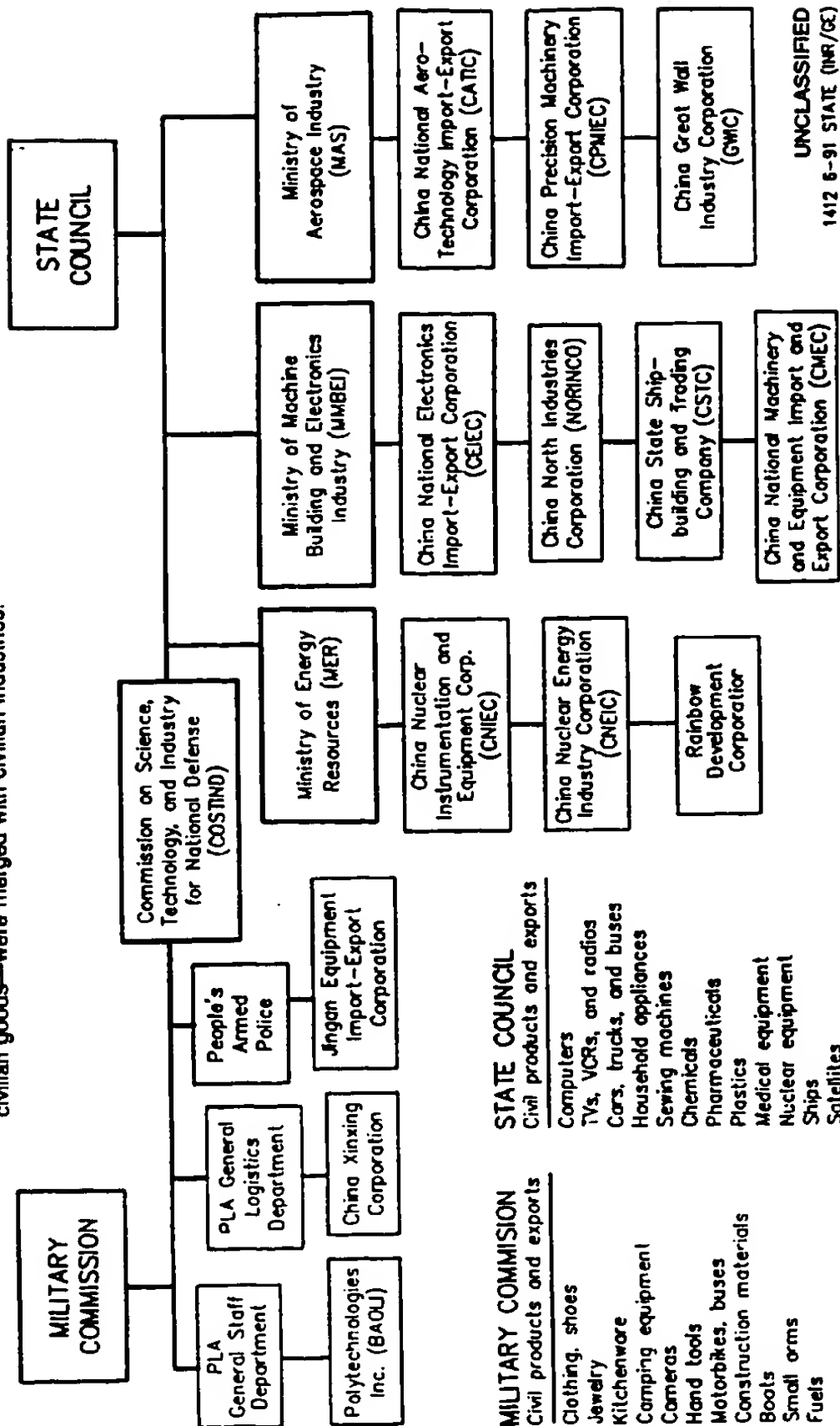
Several hundred additional plants are under the direct control of the People's Liberation Army (PLA), which is subordinate to the Military Commission. (U)

The three new ministries and COSTIND are breaking down the defense industry's wall of secrecy by promoting cross-sectoral information exchanges, the publication of journals devoted exclusively to conversion, and exhibitions at home and abroad. (U)

An important player in the process is CAPUMIT. According to General Director Jin Zhude, CAPUMIT is a "nongovernmental" organization which helps coordinate conversion policies among various organizations in the Chinese Government. Its advisory council, however, is composed of the vice ministers of the key state organizations responsible for economic and defense policy, including COSTIND's deputy director, Hual Guomo. (U)

# The Conversion of China's Defense Industry

There are two military-industrial hierarchies. The primary one is headed by the **State Council** and includes three super-ministries. The other is headed by the **Military Commission** and oversees plants under the direct control of the People's Liberation Army. A Commission on Science, Technology, and Industry for National Defense coordinates overall trade policy. R&D, and production as it affects the military sectors. This structure is the result of a decade of conversion during which the six "Soviet-modeled" defense industrial ministries—about 20 percent of whose production was civilian goods—were merged with civilian industries.



## **Problems Remain**

## **Mentor Learning From Student?**

One of the discussion topics during General Secretary Jiang Zemin's May visit to the USSR was China's success in shifting military enterprises to civilian purposes. The extent to which Soviet defense-industrial leaders are already philosophically attuned

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Opposite: The Hualong Machinery Factory, a major producer of AK-47 rifles and other small arms, is now making bicycles and exercycles. (Page from CAPUMIT's "Monograph of Ten Years' Integration of Military and Civilian Production of China National Defense Industries," which portrays the results of conversion of 150 defense plants.) (U)

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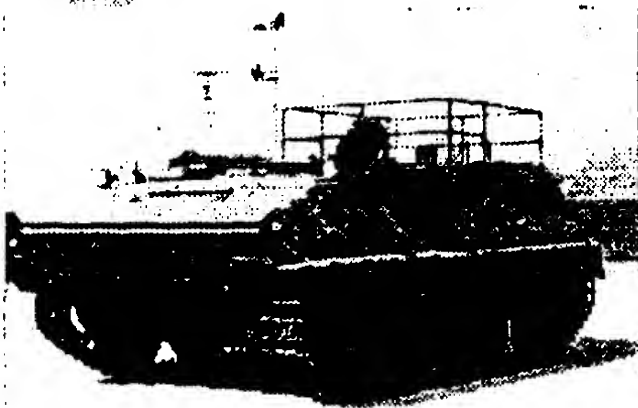
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to Beijing's type of state-administered restructuring is apparent in the following similarities in their approach:

- reduce the strategic threat perception; cut defense spending and weapons production;
- centrally control conversion policy and implementation;
- continue state direction of strategic industries;
- strip away secrecy from weapons facilities and technologies;
- integrate civilian ministries with defense industry;
- encourage defense-to-civilian technology transfer;
- keep military production lines "warm" or "laid away" through diversification;
- retain the defense industry's priority access to materials;
- subsidize financially weak defense plants;
- seek foreign financial and technical involvement.

The USSR's defense industry and ministerial bureaucracy are much larger than China's, however, and the resistance of Soviet defense managers to change is proportionately stronger. Chinese defense managers also have had a relatively successful civilian model to follow, whereas their Soviet counterparts still see few economic reasons to push conversion. (U)

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Opposite: The Beijing North Vehicle Manufactory, a major producer of armored vehicles including tanks, now produces "Neoplan" coach buses through a joint venture with Daimler Benz. It also uses an APC chassis to produce crawler-type forest fire fighting vehicles. (Page from CAPUMIT's "Monograph of Ten Years' Integration of Military and Civilian Production of China National Defense Industries," which portrays the results of conversion of 150 defense plants.) (U)

## USSR Faces the Inevitable

As Moscow makes sharper cuts in weapons procurement, Soviet defense managers will have little choice but to civilianize their product lines. If the Chinese model is followed, the heavyhanded Soviet ministerial hierarchy will have to be overhauled. Gorbachev already has suggested that, as economic reforms progress, these ministries will be slimmed down and transformed into purely policy-setting institutions with little operational control. At the same time, defense managers will have to be granted much greater authority in running their enterprises. (U)

## A Soviet Advantage?

If political and economic reforms in the USSR result in a high degree of local autonomy under a new Union treaty—and if large-scale foreign lending and investment become a reality—the USSR's conversion might face fewer obstacles than China's. Soviet defense plants, the military R&D system, and the country's overall economic infrastructure are clearly superior to those in China a decade ago. Although many plants are located beyond the Urals in defense "company towns," they are not nearly as isolated as China's third tier.

Moreover, there are hundreds of major plants in Moscow, Leningrad, and other industrial cities far closer to potential domestic and international markets than in China's case. Even in the current unsettled environment, some Soviet defense managers have been pursuing Western technology, capital investment, loans, and joint ventures because they see access to international markets as the key to successful conversion. (U)

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